



DEPARTMENT OF THE TREASURY

Internal Revenue Service
TE/GE EO Examinations
1100 Commerce Street
Dallas, TX 75424

**TAX EXEMPT AND
GOVERNMENT ENTITIES
DIVISION**

Date: January 23, 2015

Release Number: 201517010
Release Date: 4/24/2015
UIL code: 501.03-00

Person to Contact:
Phone:
Identification Number:
In Reply Refer to: TE/GE Review Staff

**LAST DATE FOR FILING A PETITION
WITH THE TAX COURT: April 16, 2015**

CERTIFIED MAIL - Return Receipt Requested

Dear

This is a Final Adverse Determination Letter as to your exempt status under section 501(c)(3) of the Internal Revenue Code. Your exemption from Federal income tax under section 501(c)(3) of the code is hereby revoked effective January 1, 20XX.

Our adverse determination was made for the following reasons:

Organizations described in I.R.C. § 501(c)(3) and exempt under section 501(a) must be both organized and operated exclusively for exempt purposes. You have failed to produce documents or otherwise establish that you are operated exclusively for exempt purposes and that no part of your net earnings inures to the benefit of private shareholders or individuals. Further, your activities more than insubstantially further non-exempt purposes, and you operate primarily for the benefit of private rather than public interests. And you failed to respond to repeated reasonable requests to allow the Internal Revenue Service to examine your records regarding your receipts, expenditures, or activities as required by I.R.C. § 6001, 6033(a)(1) and the regulations thereunder.

Contributions to your organization are no longer deductible under section 170 of the Internal Revenue Code.

You are required to file Federal income tax returns on Form 1120. These returns should be filed with the appropriate Service Center for the year ending December 31, 20XX, and for all years thereafter.

Processing of income tax returns and assessment of any taxes due will not be delayed should a petition for declaratory judgment be filed under section 7428 of the Internal Revenue Code.

If you decide to contest this determination in court, you must initiate a suit for declaratory judgment in the United States Tax Court, the United States Claim Court or the District Court of the United States for the District of Columbia before the 91st day after the date this determination was mailed to you. Contact the clerk of the appropriate court for the rules for initiating suits for declaratory judgment.

You also have the right to contact the office of the Taxpayer Advocate. However, you should first contact the person whose name and telephone number are shown above since this person can access your tax information and can help you get answers.

You can call 1-877-777-4778 and ask for Taxpayer Advocate assistance. Or you can contact the Taxpayer Advocate from the site where the tax deficiency was determined by calling, Tel: _____, or write :

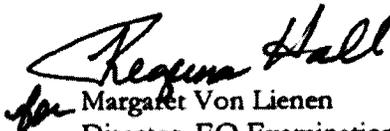
Local Taxpayer Advocate

Taxpayer Advocate assistance cannot be used as a substitute for established IRS procedures, formal appeals processes, etc. The Taxpayer Advocate is not able to reverse legal or technically correct tax determinations, nor extend the time fixed by law that you have to file a petition in the United States Tax Court. The Taxpayer Advocate can, however, see that a tax matter that may not have been resolved through normal channels gets prompt and proper handling.

We will notify the appropriate State Officials of this action, as required by section 6104(c) of the Internal Revenue Code.

If you have any questions, please contact the person whose name and telephone number are shown in the heading of this letter.

Sincerely yours,


Margaret Von Lienen
Director, EO Examinations

Enclosures:
Publication 892

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| Form 886A | Department of the Treasury - Internal Revenue Service | Schedule No. or Exhibit |
| Explanation of Items | | |
| Name of Taxpayer | | Year/Period Ended December 31, 20XX and December 31, 20XX |

ISSUE(S):

Whether _____, hereafter "the organization" continues to qualify for exemption under Section 501(c)(3) of the Internal Revenue Code.

FACTS:

The organization was granted exemption under 501(c)(3) of the Internal Revenue Code per a determination letter issued June 16, 20XX. The organization also terminated in September 20XX. The organization was founded and operated by _____, who serves as its President. Based on its Articles of Incorporation, the organization's purposes are to:

- a) Visit those hospitalized in Veterans Administration hospitals.
- b) Furnish personal items and services to hospitalized veterans.
- c) Assist homeless veterans with food baskets, blankets, temporary housing, job placement, and transportation services.

Article IV of the Articles of Incorporation states in part:

"The Corporation is organized exclusively for charitable, religious, educational and scientific purposes, including for such purposes, making distributions to organizations that qualify as exempt under section 501(c)(3) of the Internal Revenue Code, or the corresponding section of any future federal tax code.

The property of this corporation is irrevocably dedicated to charitable purposes and no part of the net income or assets of this corporation shall inure to the benefit of any director, officer or member thereof, or to the benefit of any private person.

The manner of distribution of assets in this Corporation's winding up is as follows:

Upon dissolution of the Corporation, assets shall be distributed for one or more exempt purposes within the meaning of section 501(c)(3) of the Internal Revenue Code...or shall be distributed to the federal government, or state or local government for public purpose. Any such assets not so disposed of shall be disposed of by the court of competent jurisdiction of the county in which the principal office of the corporation is then located, exclusively for such purpose, or to such organizations as said Court shall determine which are organized and operated exclusively for such purposes."

The organization's 20XX 990 Return of Organization Exempt from Income Tax lists on page 7 its Board of Directors as:

- President
- Secretary
- Treasurer

_____ retained the services of a CPA to act as his Power-of-Attorney (POA) to conduct the examination. During the initial interview, the POA related that _____ is _____ mother, and _____ is another relative.

The organization's largest independent contractor, a fundraising business named _____, is owned by one of _____ brothers.

On the organization's form 1023 - Application for Recognition of Exemption, the org answered a number of questions in Part V related to business and family relationships.

Question 2a: Are any of your officers, directors, or trustees related to each other through family or business relationships? The organization answered 'No' to this question.

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Question 2c: Are any of your officers, directors, or trustees related to your highest compensated employees or highest compensated independent contractors...through family or business relationships? The firm answered 'No' to this question.

Question 7a: Do you or will you purchase any goods, services, or assets from any of your...highest compensated independent contractors...the firm answered 'No' to this question.

Part VIII, question 4b: Do you or will you have written or oral contracts with any individuals or organizations to raise money for you? The firm answered 'No' to this question.

, president, stated through his Power-of-Attorney, , all his accounting records were on computer, that the computer contracted a virus, and all records were lost. recently moved, and any paper copies of business transactions have been misplaced. There were no Bylaws, or Board meeting minutes. The years under exam were 20XX and 20XX, the only two years the org was in existence. POA obtained copies of bank statements for the two years, and had a member of her staff code and categorize all activity; I reviewed the transactions for correctness.

There were a number of disbursements the Revenue Agent questioned as to the exempt nature of the transaction. In addition, assets were purchased in both years, such as office equipment and furniture, and vehicles, which if owned by the organization, would need to be distributed to similar 501(c)(3) entities when terminated and dissolved in late summer 20XX; there was no evidence the organization properly distributed such assets.

The examination turned up issues in other accounting and tax areas, so related cases were opened. Due to client issues, the POA informed us she is no longer working with , and we should work with the taxpayer directly. We sent a letter asking to come in for an interview and have a chance to show the questionable expenditures were not for his personal benefit; he never responded. We sent statute extensions with cover letters; he never responded.

LAW:

§ 1.501(c)(3)-1(a) In order to be exempt as an organization described in section 501(c)(3), entities must be both organized and operated exclusively for religious, charitable, scientific, testing for public safety, literary, or educational purposes, or for the prevention of cruelty to children or animals. If an organization fails to meet either the organizational test or the operational test, it is not exempt.

Operational Test:

- 1) *Primary activities.* An organization will be regarded as operated exclusively for one or more exempt purposes only if it engages primarily in activities which accomplish one or more of such exempt purposes specified in section 501(c)(3). An organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose.
- 2) *Distribution of earnings.* An organization is not operated exclusively for one or more exempt purposes if its net earnings inure in whole or in part to the benefit of private shareholders or individuals.

Treasury Regulation section 1.6001-1(c) Exempt Organizations. "In addition to such permanent books and records as are required by paragraph (a) of this section with respect to the tax imposed by section 511 on unrelated business income of certain exempt organizations, every organization exempt from tax under section 501(a) shall

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keep such permanent books of accounts or records, including inventories, as are sufficient to show specifically the items of gross income, receipts and disbursements. Such organizations shall also keep such books and records as are required to substantiate the information required by section 6033.

Treasury Regulation section 1.501(c)(3)-1(c). Operational Test. (2) Distribution of Earnings. An organization is not operated exclusively for one or more exempt purposes if its net earnings inure in whole or in part to the benefit of private shareholders or individuals.

Treasury Regulation section 1.501(c)(3)-1(d). Exempt purposes. (1)(ii) An organization is not organized or operated exclusively for one or more of the purposes specified in subdivision (i) of this subdivision unless it serves a public rather than a private interest. Thus to meet the requirement of this subdivision, it is necessary for an organization to establish that it is not organized or operated for the benefit of private interests such as designated individuals, the creator or his family, shareholders of the org, or persons controlled, directly or indirectly, by such private interests.

Arlie Foundation v. IRS 283 F Supp 2d 58 (D.D.C 2003) the district court found that the operational test requires both an organization engage "primarily" in activities that accomplish its exempt purpose and that not more than an "insubstantial part of its activities" further a non-exempt purpose. Though an incidental non-exempt purpose will not automatically disqualify an organization, the "presence of a single nonexempt purpose, if substantial in nature, will destroy the exemption, regardless of the number or importance of truly exempt purposes."

GOVERNMENT POSITION:

In accordance with the above-cited provisions of the Code and Regulations under 501(c)(3), Treasury Regulation §1.501(c)(3), and court cases listed above, the Organization is not the type of an organization for which an exemption from tax was intended.

1. **Operational Test - § 1.501(c)(3)-1** For an organization to be exempt as an organization described in section 501(c)(3) it has to meet the operational test. An organization will not be so regarded if more than an insubstantial part of its activities is not in furtherance of an exempt purpose. In both of its years of operations, had questionable expenditures that appear to be for the benefit of the founder, for which the organization provided no substantiation that the disbursements were for charitable purposes.
2. **Lack of Adequate Records – 1.274-5T(2)(c)(i).** stated he had the organization's accounting system on a computer, the computer was infected by a virus, and that all information was lost. Also, in a move of residences, all paper records were misplaced or lost. His POA was able to obtain bank statements which showed revenues and disbursements, but could not or would not, provide explanations for the business or charitable purpose of the transactions. Since the taxpayer was non-communicative, the IRS presumed all questionable transactions were not business or charity related (thus personal in nature) and were disallowed.
3. **Distribution of earnings -** An organization is not operated exclusively for one or more exempt purposes if its net earnings inure in whole or in part to the benefit of private shareholders or individuals. Regs. 1.501(c)(3)-1(d)(1)(ii) states that the burden of proof is upon the organization to establish that it is not organized or operated for the benefit of private interests. This requirement applies equally to inurement and private benefit issues. In this case, the Agent identified questionable transactions from the business bank account that were not substantiated for an exempt purpose. These transactions appear to be personal and for the benefit of . Also, upon dissolution of the organization in 20XX, remaining assets should have been distributed to other 501(c)(3) entities, or to the federal government, or to state or local government for public purposes. provided no documentation that the remaining assets were distributed as they should have been. The Service thus presumes he retained them for his own use.

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TAX PAYER POSITION:

Taxpayer has not communicated with the Service.

CONCLUSION:

The organization has several violations that jeopardize its exempt status: 1) the organization is not operated exclusively for exempt purposes, 2) inadequate records to support exempt activities, and 3) inurement to . All of these issues are in violation of 501(c)(3).

- 1) Questionable disbursements totaling \$ in 20XX, and \$ in 20XX were identified and presented to to explain the business or charitable purpose of the transactions. He did not respond. This is inurement, which is prohibited, and as such is a basis for revocation.
- 2) The taxpayer was unable to provide any books, records, or other documentation of the business and/or charitable transactions of the organization, as required by Treasury Regulation 1.6001-1(c). The POA was able to obtain bank statements, and compile lists of revenues and disbursements, but could not or would not, provide explanations of the transactions. The lack of the required adequate books and records is a basis for revocation.
- 3) In addition to the questionable disbursements that appear to be for the benefit of the taxpayer, the organization provided no evidence that remaining assets to distributed to similar 501(c)(3) organizations or to the federal government, or to state or local governments upon dissolution of , thus the value of the assets are considered to have inured to the private benefit of .

The Government concludes that the Exempt Organization does not meet the requirements to be recognized as exempt from federal income tax under 501(c)(3) of the Internal Revenue Code. Accordingly, the organization's exempt status should be revoked effective January 1, 20XX.